SUPREME COURT, U.S.
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No. 983

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1963

CHICAGO, NORTH SHORE AND MILWAUKEE RAILWAY COMPANY, *Petitioner*,

v.

UNITED STATES OF AMERICA, *Respondent*.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

## PETITIONER'S REPLY

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1. The respondent's Memorandum in Opposition does not even mention the first reason for granting the writ set forth in the Petition. The interest accrued from January 1, 1944, to the respective dates of the sale of the collateral bonds in 1944, was $81,392.82. This amount which was stipulated to be interest was not allowed as a deduction by either the trial court or the Court of Appeals. The failure to allow such de-

duction is clearly in conflict with the three Court of Appeals cases cited at page 8 of the Petition, one of which cases was affirmed per curiam by the Supreme Court.

The respondent's failure to meet this point is an obvious admission of its merits.

2. Respondent states that the increase in liabilities resulting from the sale of the bonds in 1944, approximately $4,185,029.07, was not accruable and deductible in 1944 because, contrary to petitioner's contention, it was not a cost of the 1932 financing arrangement.

Neither the respondent nor the Court of Appeals opinion fully states petitioner's contention.

Petitioner contends that the $4,185,029.07 was an obligation incurred in the regular course of business and is deductible in 1944 when it accrued unconditionally. *United States* v. *Consolidated Edison Co.*, 1961, 366 U.S. 380, 384, 81 S. Ct. 1326, 1329, supports this contention.

Whether the amount be designated as a cost of the 1932 financing arrangement or whether it is called wholly principal, or partly principal and partly interest or by some other name is immaterial. It was an obligation incurred in the normal course of business and is deductible as an ordinary and necessary business expense. Cf. *Commissioner* v. *Heininger*, 1943, 320 U.S. 467, 471, 64 S. Ct. 249, 252.

The failure to allow the deduction is in conflict with the *Consolidated Edison Co.* case, *supra*, and the cases cited therein.

3. Both courts below held that the $4,185,029.07 must be amortized as bond discount over the intervening

period to the original due date of the Series B and C Bonds in 1956 (ignoring the fact that the Series A bonds' original maturity date was January 1, 1955).

As pointed out at page 20 of the Petition, the bonds contained an acceleration provision that upon an adjudication in bankruptcy or upon appointment of a receiver, the principal of all of the bonds "*shall thereupon become due and payable*". Paragraph 1 of the Stipulation of Facts shows the appointment of receivers and subsequent bankruptcy proceedings, prior to the sale of the collateral bonds in 1944.

The collateral bonds, therefore, matured and became due and payable forthwith upon their sale in 1944. They were, in effect, demand obligations. *There was no future maturity date to which the $4,185,029.07 could be amortized.*

This was pointed out at pages 20-21 of the Petition. The petition also states, at page 12:

> "There is no statutory provision, no regulation, and so far as we are aware no court decision, other than the present one, which requires the amortization of bond discount beyond the date when such obligation matures and becomes due and payable."

The respondent did not choose to even mention the foregoing in its Memorandum in Opposition, thus in effect conceding, as we think it must, the correctness thereof. It cites no cases, regulations or rulings to the contrary.

The decision of the courts below requiring amortization beyond the accelerated maturity date when the $4,185,029.07 became due and payable upon the sale of the collateral bonds in 1944, is in conflict with the

rationale of *Helvering* v. *Union Pacific R. Co.*, 1934, 293 U.S. 282, 284, 286, 55 S. Ct. 165, 166-168, and all other bond discount cases, and is in conflict with the "all events" rule of accrual deduction reaffirmed in *United States* v. *Consolidated Edison Co.*, 1961, 366 U.S. 380, 81 S. Ct. 1326.

4. The Memorandum in Opposition defends the disallowance of accrued interest on the three promissory notes, (two held by Reconstruction Finance Corporation and the other held by a bank) upon the ground that the obligation to pay interest lacked reality. It did not attempt to reconcile the present case with the Court of Appeals cases and the Supreme Court case cited at page 14 of the Petition, except to say that, in the cited cases, the obligations were genuine.

The note obligations in the present case were genuine obligations allowed as claims in the bankruptcy proceeding.

On this point the present case is in direct conflict with the three Fifth and Eight Circuit cases cited on page 14 of the Petition.

5. The major thrust of the contention made in the Memorandum in Opposition is that the collateral bond obligations were not genuine obligations because the obligor was insolvent, and hence, the obligations lacked reality. And it quotes from the Court of Appeals opinion to the effect that there was no "absolute liability" to pay the same.

Such argument confuses the issue. There was a genuine unconditional legal liability to pay the collateral bond obligation in full immediately upon the sale thereof in 1944. There was some twelve million

dollars, face amount Series A, B and C bonds outstanding *in addition* to three and one-half million face value of the collateral bonds. The claims of the collateral bonds purchasers were fully allowed in the Chapter X proceeding both as to principal and past accrued interest as real and genuine claims. They were allowed both as to principal and interest, to the same extent, and exactly the same manner and amount as the claims of the other bondholders, who held the balance of the outstanding issue. And all of these bonds were paid off by the successor corporation by the payment of cash and an issue of the latter's common stock, the new corporation having a net worth of over twenty million dollars as shown by its balance sheet.

They were genuine obligations and were paid in full.

6. The Memorandum in Opposition is most unusual in that it does not cite a single case, it does not discuss any of the cases cited in the Petition, nor does it point out how or why the cases cited in the Petition are not in conflict with the present case. It merely states that the cited cases are not in point.

The Memorandum in Opposition is, in substance a confession and advoidance, with, we suggest, very little of the latter. Petitioner respectfully submits that the Petition should be granted.

Respectfully submitted,

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